SaskTel

# Third Quarter Report

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Saskatchewan Telecommunications Holding Corporation

Third Quarter Report 2010

For the Period Ending September 30, 2010

**Saskatchewan Telecommunications Holding Corporation** (SaskTel) is a Saskatchewan Crown corporation. SaskTel is the leading full service communications provider in Saskatchewan, offering a wide range of communications products and services including competitive voice, data, internet, entertainment, security monitoring, messaging, cellular, wireless data and directory services. In addition, SaskTel International offers software solutions and project consulting in countries around the world.

SaskTel and our wholly-owned subsidiaries have a workforce of approximately 4,700 permanent, part-time, casual, and temporary employees including all interns, co-op and summer students.

Our vision is "*To improve the lives of everyone we serve each and every time*" and our mission is *"We will go beyond in delivering innovative information, communication and entertainment solutions to our customers in Saskatchewan and other select markets. We will be a socially and environmentally responsible organization that delivers sound financial returns. Our focus is our Customer. Our strength is our People".*

# Financial Highlights

## Consolidated Net Income

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|---|---|---|---|---|---|---|
| Millions of dollars | **2010** | 2009 | % Change | **2010** | 2009 | % Change |
| Operating revenues | **$279.8** | $285.9 | (2.1) | **$830.3** | $839.3 | (1.1) |
| Operating expenses | **228.4** | 235.8 | (3.1) | **697.3** | 709.4 | (1.7) |
| Income from operations | **51.4** | 50.1 | 2.6 | **133.0** | 129.9 | 2.4 |
| Other items | **3.1** | 1.5 | 106.7 | **12.0** | 4.1 | 192.7 |
| Interest and related items | **(4.1)** | (4.1) | - | **(13.4)** | (15.3) | (12.4) |
| Income before the following | **50.4** | 47.5 | 6.1 | **131.6** | 118.7 | 10.9 |
| Gain on disposal of intangible assets | **-** | - | - | **-** | 3.1 | (100.0) |
| Income from continuing operations | **50.4** | 47.5 | 6.1 | **131.6** | 121.8 | 8.0 |
| Net earnings from discontinued operations | **0.8** | 0.2 | 300.0 | **2.9** | 1.6 | 81.3 |
| Net income | **$51.2** | $47.7 | 7.3 | **$134.5** | $123.4 | 9.0 |

SaskTel's net income for the third quarter of 2010 was $51.2 million, up $3.5 million (7.3%) from the same period in 2009.

Year-to-date net income is $134.5 million, up $11.1 million from 2009. Operating revenues decreased by $9.0 million (1.1%) from the same period last year primarily due to decreased out-of-province revenues partially offset by growth in cellular and *Max*™ Entertainment services. Operating expenses decreased $12.1 million (1.7%) from the same period last year due to reduced out-of-province expenses, depreciation and restructuring charges partially offset by increases in direct expenses related to revenue growth and one-time items recorded in 2009. Other items increased due to Provincial Sales Tax (PST) refunds and increased Rural Infrastructure Program deferred revenue amortization.

# Management Discussion and Analysis

## Forward-Looking Information

The following discussion focuses on the consolidated financial position and results of the operations of SaskTel for the third quarter 2010. This discussion and analysis should be read in conjunction with SaskTel's audited financial statements for the year ended December 31, 2009. Some sections of this discussion include forward-looking statements about SaskTel's corporate direction and financial objectives. A statement is forward-looking when it uses information known today to make an assertion about the future. Since these forward-looking statements reflect expectations and intentions at the time of writing, actual results could differ materially from those anticipated if known or unknown risks and uncertainties impact the business, or if estimates or assumptions turn out to be inaccurate. As a result, SaskTel cannot guarantee that any of the predictions forecasted by forward-looking statements will occur. As well, forward-looking statements do not take into consideration the effect of transactions or non-recurring items announced or occurring subsequently. Therefore, SaskTel disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. For a full discussion of risk factors, please consult Management's Discussion & Analysis in SaskTel's 2009 annual report. These interim statements have been prepared in accordance with the Canadian Institute of Chartered Accountants section 1751, "Interim Financial Statements." These interim statements have been approved by the SaskTel Board of Directors.

## Results of Operations

### Operating revenues

| Millions of dollars | 2010 | 2009 | Change | % |
|---|---|---|---|---|
| Three months ended September 30, | **$279.8** | $285.9 | $(6.1) | (2.1) |
| Year-to-date | **$830.3** | $839.3 | $(9.0) | (1.1) |

Operating revenues for the third quarter were $279.8 million, a decrease of $6.1 million from the same period in 2009. Year-to-date operating revenues were $830.3 million which represents a $9.0 million decrease from 2009. The decrease was driven primarily by out-of-province revenue reductions as a result of the divestiture of selected out-of-province assets in 2009, partially offset by increased cellular, *Max* Entertainment and internet revenues.

### Operating expenses

| Millions of dollars | 2010 | 2009 | Change | % |
|---|---|---|---|---|
| Three months ended September 30, | **$228.4** | $235.8 | $(7.4) | (3.1) |
| Year-to-date | **$697.3** | $709.4 | $(12.1) | (1.7) |

Operating expenses were $228.4 million for the third quarter, down $7.4 million from the same period in 2009. Year-to-date expenses decreased to $697.3 million, down $12.1 million from 2009. The decrease was primarily due to reduced out-of-province expenses, restructuring charges and depreciation, partially offset by increased direct costs to support revenue growth in cellular, *Max* Entertainment and internet services and one-time items recorded in 2009.

### Other items

Other items for the third quarter of 2010 were $3.1 million, $1.6 million higher than the same period in 2009. Year-to-date, other items were $12.0 million; $7.9 million higher than 2009 primarily due to PST refunds and increased Rural Infrastructure Program deferred revenue amortization.

### Interest and related items

Interest and related items were $4.1 million for the third quarter in both 2009 and 2010. Year-to-date, interest and related costs were $13.4 million, down $1.9 million from 2009 due to increases in the fair value of financial instruments.

## Liquidity and Capital Resources

### Cash provided by operating activities

| Millions of dollars | 2010 | 2009 | Change | % |
|---|---|---|---|---|
| Three months ended September 30, | **$85.5** | $90.2 | $(4.7) | (5.2) |
| Year-to-date | **$206.2** | $220.7 | $(14.5) | (6.6) |

Cash provided by operating activities in the first nine months was down $14.5 million when compared to the same period in 2009 due to reduced cash from operations and increased working capital requirements.

### Cash used in investing activities

| Millions of dollars | 2010 | 2009 | Change | % |
|---|---|---|---|---|
| Three months ended September 30, | **$90.9** | $60.0 | $30.9 | 51.5 |
| Year-to-date | **$213.8** | $107.0 | $106.8 | 99.8 |

Cash used in investing activities increased by $30.9 million to $90.9 million in the third quarter of 2010 compared to the same period in 2009. Year-to-date cash used in investing activities increased by $106.8 million from the same period in 2009 to $213.8 million in 2010. The increase can primarily be attributed to the cellular network upgrade to Universal Mobile Telecommunications System (UMTS)/High Speed Packet Access (HSPA) technology, commonly known as 3G+, and the Saskatchewan Infrastructure Improvement Program, which is providing last mile broadband to 100% of rural Saskatchewan, cellular expansion to 98% of the population of Saskatchewan and backbone infrastructure upgrades to increase basic internet to 5 megabits per second.

### Cash provided by (used in) financing activities

| Millions of dollars | 2010 | 2009 | Change | % |
|---|---|---|---|---|
| Three months ended September 30, | **$9.1** | $(24.3) | $33.4 | (137.4) |
| Year-to-date | **$11.1** | $(106.8) | $117.9 | (110.4) |

Cash provided by financing activities during the third quarter was $9.1 million compared to a use of cash of $24.3 million for the same period in 2009. Year-to-date cash provided by financing activities was $11.1 million compared to a use of cash of $106.8 million in 2009. During 2010, short-term borrowings increased by $48.2 million versus net repayment of $31.7 million for the same period in 2009. Long-term debt increased by a net amount of $58.7 million. This is the result of a new debt issue with net proceeds of $148.7 million and debt repayment of $90.0 million. In addition, sinking fund redemptions contributed $11.3 million. There was minimal long-term debt activity for the same period in 2009. In addition, SaskTel paid a dividend of $105.8 million to Crown Investments Corporation of Saskatchewan compared to $73.0 million for the same period in 2009.

### Liquidity and capital resource ratios

#### Debt ratio

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Debt ratio | **30.8%** | 24.4% |

The debt ratio as at September 30, 2010 increased to 30.8% from 24.4% at December 31, 2009. The overall level of net debt increased $105.0 million due primarily to an increase in investing activities in 2010. In addition, retained earnings increased by $11.0 million to the end of the third quarter after recording net income of $134.5 million and dividends of $123.5 million.

## 2010 Outlook

The 2009 SaskTel Annual Report identified a consolidated net income target for 2010 of $118.3 million. At this time SaskTel believes that it will significantly exceed this target.

## Risk Assessment

The 2009 Annual Report discusses the risks and uncertainties in SaskTel's business environment. They include developments in technology and the economic and regulatory environments, challenges faced by the defined benefit pension plan, competitive activity, cost management initiatives and more. SaskTel's basic risk profile remains unchanged as at September 30, 2010. Management continues to monitor individual risks as they change and evolve and employs the industry accepted risk management processes of identification, mitigation, transfer, assumption and control of key risks.

## Future Accounting Changes - International Financial Reporting Standards (IFRS)

Canadian public companies including Government Business Enterprises (GBEs) will be required to prepare their financial statements in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB), for fiscal years beginning on or after January 1, 2011. Effective January 1, 2011, SaskTel and its subsidiaries, as GBEs, will adopt IFRS as the basis for preparing consolidated financial statements. SaskTel will report financial results for the quarter ended March 31, 2011 prepared on an IFRS basis. SaskTel will also provide comparative data on an IFRS basis, including an opening balance sheet as at January 1, 2010.

SaskTel and its subsidiaries, have virtually finalized an IFRS conversion project including selection of accounting policies and financial statement presentation formats and determination of the most significant impacts of IFRS on processes, systems, internal controls over financial reporting and disclosures, and future financial position and results of operations. As part of the IFRS implementation, SaskTel has made changes to certain processes and systems to ensure transactions are recorded in accordance with IFRS for comparative reporting purposes.

SaskTel has provided a reconciliation of the Province's equity as at the date of transition, and estimated impacts on Key Performance Indicators. While this reconciliation does not represent an official adoption of IFRS, it provides an indication of the major differences identified to date, relative to SaskTel's historical financial statements. The possibility exists that the information provided may require adjustment before constituting the comparative information in the first complete set of 2011 IFRS interim financial statements prepared in accordance with IAS 34: "Interim Financial Reporting", because of revisions or changes to standards or interpretations on the application of a particular IFRS, or voluntary changes to IFRS 1 exemptions (mandatory exceptions and optional exemptions) or policies as selected by the Corporation.

**Province's equity as at the date of transition:**

| Thousands of dollars | January 1, 2010 |
|---|---|
| Province's equity under Canadian GAAP | $811,799 |
| 1. Employee benefits expenses | (193,560) |
| 2. Deemed cost | 109,280 |
| 3. Directly attributable costs | (44,770) |
| 4. Borrowing costs | 26,562 |
| 5. Revenue recognition | 21,522 |
| 6. Prepaid publishing costs | (5,129) |
| 7. Componentization | 294 |
| 8. Capital provisions | (402) |
| Province's equity under IFRS | $725,596 |

1. Employee benefits expenses
   Canadian GAAP – Actuarial gains and losses are recognized on a systematic and consistent basis, subject to a minimum required amortization based on a "corridor" approach. Unrecognized actuarial gains and losses below the corridor are deferred.

   IFRS – In accordance with SaskTel's IFRS1 election, actuarial gains and losses are recognized immediately into retained earnings.

2. Deemed cost
   Canadian GAAP – The measurement of capital assets is based on historical cost.

   IFRS – In accordance with SaskTel's IFRS1 election certain items of property, plant and equipment have been revalued to fair value at the date of transition to IFRS.

3. Directly attributable costs
   Canadian GAAP – SaskTel capitalized overheads attributable to construction and development activities, including general and administrative overhead costs.

   IFRS – Only directly attributable costs are capitalized to an item of property plant and equipment.

4. Borrowing costs
   Canadian GAAP – SaskTel was not required to capitalize borrowing costs related to qualifying assets.

   IFRS – SaskTel is required to retroactively capitalize borrowing costs on qualifying assets.

5. Revenue recognition
   Canadian GAAP – SaskTel recognized directory advertising revenues in accordance with the contractual terms with advertisers, on a monthly basis over the life of the print directory.

   IFRS – Directory revenues are recognized when each directory is distributed to the public.

6. Prepaid publishing costs
   Canadian GAAP – Expenses directly related to directory publications were deferred and amortized over the life of the related directory.

   IFRS – Expenses are recognized when the related directory is distributed to the public.

7. Componentization
   Canadian GAAP – Certain asset components were recorded as normal repairs and maintenance due to their nature.

   IFRS – Under IFRSs these components are required to be recorded as assets and depreciated over the life of the component.

8. Capital provisions
   Canadian GAAP – Capital commitments related to healthcare contracts were recorded as incurred.

   IFRS – Capital commitments are accrued at the inception of the healthcare contract.

**Key Performance Indicators**

The indicators most impacted by SaskTel's adoption of IFRS are related to financial results and include revenue growth, net income, return on equity and the debt ratio.

Revenues will be impacted primarily by IFRS revenue recognition requirements to reduce sales revenues for subsidies provided to the consumer. The estimated annual impact for 2010 is a revenue reduction of $15 million. This revenue reduction is offset by a corresponding reduction in expenses.

Net income will be impacted by:

- interest and overhead capitalization policies,
- accounting for actuarial gains and losses, and
- changes in depreciation methodologies and estimated useful lives of certain assets.

Based on results for the first three quarters of 2010, the estimated annual impact on net income is not expected to be material.

Return on equity and the debt ratio will be impacted by the equity adjustments at the date of transition to IFRS. It is anticipated that both indicators will increase by approximately two percentage points due to the reduction of equity upon transition.

The IASB plans to make revisions to or replace existing IFRS standards that may impact these areas as well as other accounting issues. Some of the anticipated changes may be in effect prior to SaskTel's transition date, such that IFRS may differ at transition date from its current form. However, it is likely that the majority of the changes will be in effect subsequent to the date of transition; with the result that the impact to SaskTel of adopting IFRS will extend beyond its transitional year.

## Consolidated Statement of Operations and Comprehensive Income

(Unaudited)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| Thousands of dollars | **2010** | 2009 | **2010** | 2009 |
| **Operating revenues** | **$279,799** | $285,853 | **$830,307** | $839,313 |
| **Operating expenses** | | | | |
| Operations | **188,985** | 193,828 | **580,560** | 579,953 |
| Depreciation and amortization | **39,460** | 42,147 | **116,773** | 125,470 |
| Restructuring charges | **-** | (213) | **-** | 3,963 |
| | **228,445** | 235,762 | **697,333** | 709,386 |
| **Income from operations** | **51,354** | 50,091 | **132,974** | 129,927 |
| **Other items** | **3,140** | 1,498 | **11,967** | 4,090 |
| **Interest and related items** (Note 3) | **(4,048)** | (4,136) | **(13,358)** | (15,359) |
| **Income before the following** | **50,446** | 47,453 | **131,583** | 118,658 |
| **Gain on disposal of intangible assets** | **-** | - | **-** | 3,073 |
| **Income from continuing operations** | **50,446** | 47,453 | **131,583** | 121,731 |
| **Net earnings from discontinued operations** (Note 4) | **789** | 286 | **2,900** | 1,630 |
| **Net income** | **51,235** | 47,739 | **134,483** | 123,361 |
| **Other comprehensive income** | **-** | - | **-** | - |
| **Comprehensive income** | **$51,235** | $47,739 | **$134,483** | $123,361 |

*See Accompanying Notes*

## Consolidated Statement of Retained Earnings

(Unaudited)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| Thousands of dollars | **2010** | 2009 | **2010** | 2009 |
| **Retained earnings, beginning of period** | **$570,247** | $565,206 | **$561,799** | $535,997 |
| **Net income** | **51,235** | 47,739 | **134,483** | 123,361 |
| | **621,482** | 612,945 | **696,282** | 659,358 |
| **Dividends** | **48,725** | 25,768 | **123,525** | 72,181 |
| **Retained earnings, end of period** | **$572,757** | $587,177 | **$572,757** | $587,177 |

*See Accompanying Notes*

# Consolidated Statement of Financial Position

| As at<br>Thousands of dollars | (Unaudited)<br>**September 30, 2010** | December 31, 2009 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash | **$9,191** | $2,904 |
| Accounts receivable (Note 8a) | **88,315** | 90,747 |
| Inventories (Note 8a) | **8,837** | 8,020 |
| Prepaid expenses (Note 8a) | **18,063** | 15,119 |
| Current portion of sinking funds | **-** | 10,519 |
| Current assets of discontinued operations (Note 4) | **8,216** | 8,822 |
| | **132,622** | 136,131 |
| **Property, plant and equipment** | **3,114,791** | 2,937,962 |
| Less accumulated depreciation | **2,083,985** | 2,013,067 |
| | **1,030,806** | 924,895 |
| **Intangible assets – finite life** | **175,278** | 165,120 |
| Less accumulated amortization | **110,218** | 98,250 |
| | **65,060** | 66,870 |
| **Long-lived assets of discontinued operations** (Note 4) | **39,354** | 38,932 |
| **Intangible assets – indefinite life** | **65,981** | 65,981 |
| **Goodwill** | **6,076** | 6,076 |
| **Sinking funds** | **63,778** | 57,744 |
| **Deferred pension costs** | **126,556** | 108,145 |
| **Other assets** | **10,146** | 12,006 |
| | **$1,540,379** | $1,416,780 |
| **Liabilities and Province's equity** | | |
| **Current liabilities** | | |
| Accounts payable and accrued liabilities (Note 8a) | **$112,933** | $129,037 |
| Notes payable | **56,900** | 8,700 |
| Dividend payable | **48,725** | 31,026 |
| Services billed in advance (Note 8a) | **58,235** | 51,762 |
| Current portion of long-term debt | **-** | 90,109 |
| Current liabilities of discontinued operations (Note 4) | **2,447** | 2,674 |
| | **279,240** | 313,308 |
| **Non-current liabilities of discontinued operations** (Note 4) | **5,687** | 5,909 |
| **Deferred revenue** | **8,130** | 9,145 |
| **Deferred revenue – Government funding** (Note 5) | **41,600** | 42,400 |
| **Long-term debt** (Note 6) | **382,965** | 234,219 |
| | **717,622** | 604,981 |
| **Province of Saskatchewan's equity** | | |
| Equity advance | **250,000** | 250,000 |
| Retained earnings | **572,757** | 561,799 |
| | **822,757** | 811,799 |
| | **$1,540,379** | $1,416,780 |

*See Accompanying Notes*

## Consolidated Statement of Cash Flows

| | (Unaudited) | | | |
|---|---|---|---|---|
| | Three months ended September 30, | | Nine months ended September 30, | |
| Thousands of dollars | **2010** | 2009 | **2010** | 2009 |
| **Operating activities** | | | | |
| Income from continuing operations | **$50,446** | $47,453 | **$131,583** | $121,731 |
| Adjustments to reconcile net income to cash provided by operations | | | | |
| Depreciation and amortization | **39,460** | 42,147 | **116,773** | 125,470 |
| Gain on disposal of intangible assets | **-** | - | **-** | (3,073) |
| Contributions to defined benefit pension plans | **(4,061)** | (2,010) | **(12,345)** | (6,161) |
| Pension income of defined benefit plans | **(2,023)** | (2,016) | **(6,070)** | (6,049) |
| Amortization of government funding | **(284)** | (95) | **(2,121)** | (168) |
| Sinking fund earnings | **(1,476)** | (895) | **(3,244)** | (2,425) |
| Change in fair value of financial instruments | **(1,199)** | (1,098) | **(2,431)** | (641) |
| Other | **(537)** | (374) | **(2,877)** | 161 |
| Net change in non-cash working capital (Note 8b) | **5,160** | 7,086 | **(13,093)** | (8,125) |
| | **85,486** | 90,198 | **206,175** | 220,720 |
| **Investing activities** | | | | |
| Property, plant and equipment | **(86,189)** | (53,030) | **(204,864)** | (130,676) |
| Intangible assets | **(4,700)** | (6,925) | **(14,035)** | (21,365) |
| Redemption of preferred shares | **-** | - | **3,733** | - |
| Government funding (Note 5) | **-** | - | **1,321** | 45,000 |
| | **(90,889)** | (59,955) | **(213,845)** | (107,041) |
| **Financing activities** | | | | |
| Proceeds from long-term debt | **148,670** | - | **148,670** | - |
| Repayment of long-term debt | **(90,004)** | (4) | **(90,013)** | (203) |
| Sinking fund redemption | **11,260** | - | **11,260** | - |
| Short-term borrowings (repayments) | **(15,300)** | - | **48,200** | (31,700) |
| Dividends paid | **(45,242)** | (23,207) | **(105,826)** | (73,025) |
| Sinking fund installments | **-** | (900) | **(1,100)** | (2,000) |
| Capital lease obligations | **-** | - | **-** | (22) |
| Financing leases | **(235)** | (197) | **(88)** | 198 |
| | **9,149** | (24,308) | **11,103** | (106,752) |
| **Increase in cash from continuing operations** | **3,746** | 5,935 | **3,433** | 6,927 |
| **Increase in cash from discontinued operations** | **401** | 911 | **2,672** | 1,748 |
| **Cash, beginning of period** | **11,271** | 6,771 | **9,313** | 4,942 |
| **Cash, end of period** | **$15,418** | $13,617 | **$15,418** | $13,617 |
| **Comprised of:** | | | | |
| Cash of continuing operations | | | **$9,191** | $7,357 |
| Cash of discontinued operations | | | **6,227** | 6,260 |
| | | | **$15,418** | $13,617 |

*See Accompanying Notes*

# Notes to Consolidated Financial Statements (Unaudited)
**As at September 30, 2010**

## Note 1 – Interim financial statements

The unaudited interim consolidated financial statements should be read in conjunction with the Saskatchewan Telecommunications Holding Corporation's (the Corporation) December 31, 2009 audited consolidated financial statements. The interim consolidated financial statements of the Corporation have been prepared in accordance with generally accepted accounting principles in Canada. The accounting policies and methods for interim reporting purposes are consistent with those used in the preparation of the Corporation's audited consolidated financial statements for the year ended December 31, 2009.

## Note 2 – Summary of significant accounting policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying amounts of property, plant and equipment and underlying estimations of useful lives of depreciable assets and capitalization of labour and overhead, the carrying amount of goodwill and intangible assets and underlying estimates of future cash flow, the carrying amounts of accounts receivable and underlying provision for bad debts and the carrying amounts of deferred pension costs and underlying actuarial assumptions. The inherent uncertainty involved in making such estimates and assumptions may impact the actual results reported in future periods.

The accounting policies used in the preparation of these interim financial statements conform with those used in the Corporation's most recent annual consolidated financial statements.

## Note 3 – Interest and related items

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| Thousands of dollars | **2010** | 2009 | **2010** | 2009 |
| Interest on long-term debt | **$6,790** | $6,139 | **$19,101** | $18,465 |
| Sinking fund earnings – held for trading | **(1,476)** | (895) | **(3,244)** | (2,425) |
| Change in fair value of sinking fund | **(1,199)** | (1,098) | **(2,431)** | (641) |
| Other interest income | **(67)** | (10) | **(68)** | (40) |
| | **$4,048** | $4,136 | **$13,358** | $15,359 |

## Note 4 – Discontinued operations

During the second quarter of 2010, the Corporation, approved plans whereby the operations of Hospitality Network Canada, Inc. (Hospitality Network) and Saskatoon 2 Properties Limited Partnership (Saskatoon Square) will be divested and the criteria for classification as discontinued operations have been met. In addition, the Corporation had previously classified the operations of DirectWest Canada, Inc. (DirectWest Canada) as discontinued operations in 2009.

# Notes to Consolidated Financial Statements (Unaudited)
## As at September 30, 2010

*Note 4 – Discontinued operations, continued*

The results of the operations of these entities have been presented as discontinued operations in the Consolidated Statements of Operations and Cash Flows and the related assets and liabilities have been reported as assets of discontinued operations and liabilities of discontinued operations in the Consolidated Statement of Financial Position for all periods presented.

The results of discontinued operations are as follows:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| Thousands of dollars | **2010** | 2009 | **2010** | 2009 |
| **Revenues** | | | | |
| Hospitality Network | **$7,113** | $7,153 | **$22,843** | $22,723 |
| Saskatoon Square | **705** | 656 | **2,112** | 1,946 |
| DirectWest Canada | **-** | 308 | **-** | 2,629 |
| Total revenues | **$7,818** | $8,117 | **$24,955** | $27,298 |
| **Net earnings** | | | | |
| Hospitality Network | **$757** | $740 | **$2,653** | $2,839 |
| Saskatoon Square | **32** | 38 | **247** | 280 |
| DirectWest Canada | **-** | (492) | **-** | (1,489) |
| Net earnings from discontinued operations | **$789** | $286 | **$2,900** | $1,630 |

The assets and liabilities of discontinued operations are as follows:

| | September 30, 2010 | | | December 31, 2009 | | | |
|---|---|---|---|---|---|---|---|
| Thousands of dollars | **Hospitality Network** | **Saskatoon Square** | **Total** | Hospitality Network | Saskatoon Square | DirestWest Canada | Total |
| **Assets** | | | | | | | |
| Cash | **$5,785** | **$442** | **$6,227** | $5,693 | $315 | $401 | $6,409 |
| Accounts receivable | **1,599** | **-** | **1,599** | 1,968 | 77 | 42 | 2,087 |
| Prepaid expenses | **310** | **80** | **390** | 295 | 31 | - | 326 |
| Current assets of discontinued operations | **$7,694** | **$522** | **$8,216** | $7,956 | $423 | $443 | $8,822 |
| Property, plant and equipment | **$17,778** | **$6,045** | **$23,823** | $16,978 | $6,139 | $- | $23,117 |
| Intangible assets | **2,689** | **1,004** | **3,693** | 2,916 | 1,061 | - | 3,977 |
| Goodwill | **11,838** | **-** | **11,838** | 11,838 | - | - | 11,838 |
| Long-lived assets of discontinued operations | **$32,305** | **$7,049** | **$39,354** | $31,732 | $7,200 | $- | $38,932 |
| **Liabilities** | | | | | | | |
| Accounts payable and accrued liabilities | **$1,976** | **$147** | **$2,123** | $1,927 | $179 | $262 | $2,368 |
| Services billed in advance | **-** | **16** | **16** | - | 12 | - | 12 |
| Current portion of long-term debt | **-** | **308** | **308** | - | 294 | - | 294 |
| Current liabilities of discontinued operations | **$1,976** | **$471** | **$2,447** | $1,927 | $485 | $262 | $2,674 |
| Long-term debt | **$-** | **$5,687** | **$5,687** | $- | $5,909 | $- | $5,909 |
| Long-term liabilities of discontinued operations | **$-** | **$5,687** | **$5,687** | $- | $5,909 | $- | $5,909 |

*Note 4 – Discontinued operations, continued*

The cash flows from discontinued operations are as follows:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| Thousands of dollars | **2010** | 2009 | **2010** | 2009 |
| Cash provided by (used in) operating activities | | | | |
| Hospitality Network | **$2,034** | $1,624 | **$5,462** | $4,964 |
| Saskatoon Square | **291** | 321 | **1,142** | 1,163 |
| DirectWest Canada | **-** | 481 | **-** | (815) |
| Total cash provided by operating activities | **2,325** | 2,426 | **6,604** | 5,312 |
| Cash provided by (used in) investing activities | | | | |
| Hospitality Network | **(1,844)** | (1,136) | **(3,446)** | (3,388) |
| Saskatoon Square | **-** | (205) | **(247)** | (560) |
| DirectWest Canada | **-** | - | **-** | 3,210 |
| Total cash used in investing activities | **(1,844)** | (1,341) | **(3,693)** | (738) |
| Cash provided by (used in) financing activities | | | | |
| Hospitality Network | **(10)** | - | **(31)** | (33) |
| Saskatoon Square | **(70)** | (68) | **(208)** | (197) |
| DirectWest Canada | **-** | (106) | **-** | (2,596) |
| Total cash used in financing activities | **(80)** | (174) | **(239)** | (2,826) |
| Increase in cash from discontinued operations | **$401** | $911 | **$2,672** | $1,748 |

## Note 5 – Deferred revenue – Government funding

During the second quarter of 2009, the Corporation received $45,000,000 in funding from the Province of Saskatchewan through Crown Investments Corporation of Saskatchewan, as partial funding of the 2009 portion of the Rural Infrastructure Program (RIP). The funded expenditures have been completed and the funding has been applied as follows; $40,891,160 to capital expenditures and $4,108,840 to operating expenditures.

In addition, as part of the transfer of the satellite distribution and communication assets of Saskatchewan Communications Network Corporation (SCN) to the Corporation, the Province of Saskatchewan through the Ministry of Education has provided $1,321,230 in funding for distance education hardware upgrades. To date $22,965 has been applied to capital expenditures. Funded expenditures are planned for the balance of 2010 and early 2011.

Funding related to operating expenditures has been included in the determination of net income for the relevant period. Funding related to capital expenditures has been deferred and is being amortized over the estimated useful life of the related assets.

*Note 5 – Deferred revenue – Government funding, continued*

| Thousands of dollars | RIP | September 30, 2010 SCN | Total | December 31, 2009 Total |
|---|---|---|---|---|
| Balance of deferred revenue - government funding, January 1 | $42,400 | $- | $42,400 | $- |
| Funding received | - | 1,321 | 1,321 | 45,000 |
| | 42,400 | 1,321 | 43,721 | 45,000 |
| Applied to operating expenses | 1,509 | - | 1,509 | 2,600 |
| Amortization of deferred revenue | 612 | - | 612 | - |
| Total recognized in net income | 2,121 | - | 2,121 | 2,600 |
| Balance of deferred revenue – government funding, end of period | $40,279 | $1,321 | $41,600 | $42,400 |

## Note 6 – Long-term debt

On July 28, 2010 the Corporation issued $150,000,000 of long-term debt through the Province of Saskatchewan maturing on July 28, 2020 at a rate of 3.9%. The debt was issued at a discount of $1,330,500 yielding an effective interest rate of 4.01%.

## Note 7 – Contingencies

On August 9, 2004, a proceeding under the *Class Actions Act* (Saskatchewan) was brought against several Canadian wireless and cellular service providers, including Saskatchewan Telecommunications Holding Corporation and Saskatchewan Telecommunications. The proceeding involves allegations by wireless customers of breach of contract, misrepresentation, negligence, collusion, unjust enrichment and breach of statutory obligations concerning system administration fees. The Plaintiffs seek unquantified damages from the defendant wireless communications service providers. Similar proceedings have been filed by, or on behalf of, Plaintiffs' counsel in other provincial jurisdictions. On September 17, 2007, the Saskatchewan court certified the Plaintiffs' proceeding as a class action with respect to an allegation of unjust enrichment only. The appeal from this decision by the Corporation, together with all other defendants will be heard by the Court of Appeal on December 13 amd 14, 2010. On July 24, 2009 a second proceeding under the *Class Actions Act* (Saskatchewan) was issued against several Canadian wireless and cellular service providers, including Saskatchewan Telecommunications Holding Corporation and Saskatchewan Telecommunications. The Corporation believes this second action involves substantially the same allegations as the 2004 claim and on December 23, 2009 the second action was conditionally stayed as an abuse of process by the Court of Queen's Bench. The Plaintiffs have applied to obtain leave of the Court of Appeal to appeal the stay of the second action. The Corporation continues to believe that it has strong defenses to the allegations and that legal errors were made by the Court in the certification proceeding of the 2004 claim and that it has strong defenses to the allegations contained in the 2009 action.

On June 26th, 2008, a proceeding under the *Class Actions Act* (Saskatchewan) was brought against several Canadian wireline, wireless and cellular service providers, including Saskatchewan Telecommunications Holding Corporation and Saskatchewan Telecommunications. The proceeding involves allegations by wireline and wireless customers of breach of contract, misrepresentation, negligence, collusion, unjust enrichment and breach of statutory obligations concerning fees and charges paid for 9-1-1 service. The Plaintiffs seek unquantified damages from the defendant communications service providers. Thus far the claim has simply been issued by the Plaintiffs. The Corporation is not aware whether all the named defendant carriers have been served with the claim

*Note 7 – Contingencies, continued*

yet. The Corporation believes that it has strong defenses to the allegations that are made by the Plaintiffs in the claim and will be strongly defending and opposing the claims that have been made. On September 27, 2010 the Corporation was advised that a case management judge has been appointed in this matter.

Should the ultimate resolution of these actions differ from management's assessments and assumptions, a material adjustment to the Corporation's financial position or results of operations could result.

In the normal course of operations, the Corporation becomes involved in various claims and litigation. While the final outcome with respect to claims and litigation pending at September 30, 2010 cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Corporation's consolidated financial position or results of operations.

## Note 8 – Additional financial information

### a) Balance sheet

| Thousands of dollars | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Accounts receivable | | |
| Customer accounts receivable | $73,955 | $77,838 |
| Accrued receivables - customer | 4,763 | 4,704 |
| Allowance for doubtful accounts | (4,120) | (3,599) |
| | 74,598 | 78,943 |
| High cost serving area subsidy | 6,799 | 5,446 |
| Other | 6,918 | 6,358 |
| | $88,315 | $90,747 |
| Inventories | | |
| Inventories for resale | $5,991 | $6,106 |
| Work in progress | 2,537 | 1,641 |
| Raw materials | 309 | 273 |
| | $8,837 | $8,020 |
| Prepaid expenses | | |
| Prepaid expenses | $12,997 | $9,396 |
| Deferred service connection charges | 5,066 | 5,723 |
| | $18,063 | $15,119 |
| Accounts payable and accrued liabilities | | |
| Trade accounts payable and accrued liabilities | $61,079 | $71,742 |
| Payroll and other employee-related liabilities | 41,249 | 47,498 |
| Taxes payable | 5,430 | 4,971 |
| Interest payable | 4,527 | 4,310 |
| Other | 648 | 516 |
| | $112,933 | $129,037 |

*Note 8 – Additional financial information, continued*

| Thousands of dollars | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Services billed in advance | | |
| Advance billings | **$46,057** | $38,874 |
| Deferred customer activation and connection fees | **7,216** | 7,967 |
| Customer deposits | **4,962** | 4,921 |
| | **$58,235** | $51,762 |

**b) Supplementary cash flow information**

| Thousands of dollars | Three months ended September 30, 2010 | Three months ended September 30, 2009 | Nine months ended September 30, 2010 | Nine months ended September 30, 2009 |
|---|---|---|---|---|
| Net change in non-cash working capital | | | | |
| Accounts receivable | **$258** | $(4,774) | **$581** | $(4,258) |
| Inventories | **1,356** | 1,719 | **(817)** | 1,160 |
| Prepaid expenses | **3,677** | 3,181 | **(2,944)** | (2,337) |
| Accounts payable and accrued liabilities | **(3,579)** | 7,493 | **(16,260)** | (3,374) |
| Deferred revenue | **(79)** | (83) | **(1,015)** | (1,186) |
| Deferred expenses | **119** | 152 | **889** | 887 |
| Services billed in advance | **3,408** | (602) | **6,473** | 983 |
| | **$5,160** | $7,086 | **$(13,093)** | $(8,125) |
| Interest Paid | **$6,497** | $5,904 | **$18,781** | $18,188 |

## Note 9 – Financial instruments

The Corporation's financial instruments include cash, accounts receivable, sinking funds, accounts payable and accrued liabilities, notes payable, dividend payable and long-term debt, which by their nature are subject to risks.

a) Fair value

Fair values approximate amounts at which financial instruments could be exchanged between willing parties based on current markets for instruments with similar characteristics such as risk, principal and remaining maturities. Fair values are estimates using present value and other valuation techniques which are significantly affected by the assumptions used concerning the amount and timing of estimated future cash flows and discount rates that reflect varying degrees of risk. Therefore, due to the use of judgment and future-orientated information, aggregate fair value amounts should not be interpreted as being realizable in an immediate settlement of the instruments.

*Note 9 – Financial instruments, continued*

The following table represents the carrying amounts and fair values of financial assets and liabilities measured at fair value or amortized cost:

| Thousands of dollars | | September 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|---|
| Financial Instruments | Classification[1] | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| **Financial Assets** | | | | | |
| Cash | HFT | **$9,191** | **$9,191** | $2,904 | $2,904 |
| Cash of discontinued operations | HFT | **6,227** | **6,227** | 6,409 | 6,409 |
| Accounts receivable | LAR | **88,315** | **88,315** | 90,747 | 90,747 |
| Accounts receivable – discontinued operations | LAR | **1,599** | **1,599** | 2,087 | 2,087 |
| Sinking funds | HFT | **63,778** | **63,778** | 68,263 | 68,263 |
| **Financial Liabilities** | | | | | |
| Accounts payable and accrued liabilities | OL | **112,933** | **112,933** | 129,037 | 129,037 |
| Accounts payable and accrued liabilities – discontinued operations | OL | **2,123** | **2,123** | 2,368 | 2,368 |
| Notes payable | OL | **56,900** | **56,900** | 8,700 | 8,700 |
| Dividend payable | OL | **48,725** | **48,725** | 31,026 | 31,026 |
| Long-term debt | OL | **382,965** | **487,762** | 324,328 | 402,151 |
| Long-term debt – discontinued operations | OL | **5,995** | **6,344** | 6,203 | 6,624 |

[1] Classification details are:
AFS – available for sale
HFT – held-for-trading
LAR – loans and receivables
OL – other liabilities

Determination of fair value

When the carrying amount of a financial instrument is the most reasonable approximation of fair value, reference to market quotations and estimation techniques is not required. The carrying values of cash and short-term investments, accounts receivable, accounts payable and accrued liabilities, dividend payable and notes payable approximate their fair values due to the short-term maturity of these financial instruments.

For financial instruments listed below, fair value is best evidenced by an independent quoted market price for the same instrument in an active market. An active market is one where quoted prices are readily available, representing regularly occurring transactions. Accordingly, the determination of fair value requires judgement and is based on market information where available and appropriate. Fair value measurements are categorized into levels within a fair value hierarchy based on the nature of the inputs used in the valuation.

Level 1 – Where quoted prices are readily available from an active market.
Level 2 – Valuation model not using quoted prices, but still using predominantly observable market inputs, such as market interest rates.

| Thousands of dollars | September 30, 2010 Level 1 | Level 2 | Total | December 31, 2009 Level 1 | Level 2 | Total |
|---|---|---|---|---|---|---|
| Sinking funds | - | **$63,778** | **$63,778** | - | $68,263 | $68,263 |
| Long-term debt | - | **$487,762** | **$487,762** | - | $402,151 | $402,151 |
| Long-term debt - discontinued operations | - | **6,344** | **6,344** | - | 6,624 | 6,624 |
| Total liabilities | - | **$494,106** | **$494,106** | - | $408,775 | $408,775 |

*Note 9 – Financial instruments, continued*

b) Credit risk

The Corporation is exposed to credit risk through its accounts receivable and sinking fund assets. Credit risk related to sinking fund assets is minimized by dealing with institutions that have strong credit ratings. Credit risk related to customer accounts receivable is minimized because of the large and diverse customer base covering many consumer and business sectors. The Corporation evaluates customer credit risk and limits credit availability when necessary.

The aging of customer receivables from continuing operations and related to assets held for sale, which indicates potential impairment losses, are as follows:

| Continuing operations | **September 30, 2010** | December 31, 2009 |
|---|---|---|
| | | Thousands of dollars |
| Current | **$57,871** | $57,523 |
| 30-60 days past billing date | **11,200** | 12,853 |
| 61-90 days past billing date | **2,406** | 4,346 |
| Greater than 90 days past billing date | **2,478** | 3,116 |
| Total | **$73,955** | $77,838 |

| Discontinued operations | **September 30, 2010** | December 31, 2009 |
|---|---|---|
| | | Thousands of dollars |
| Current | **$1,042** | $1,221 |
| 30-60 days past billing date | **122** | 191 |
| 61-90 days past billing date | **92** | 141 |
| Greater than 90 days past billing date | **229** | 2,023 |
| Total | **$1,485** | $3,576 |

Provisions for credit losses are maintained and regularly reviewed by the Corporation, based on an analysis of the aging of customer accounts. Amounts are written off once reasonable collection efforts have been exhausted. Details of the related allowance accounts are as follows:

| Continuing operations | **September 30, 2010** | December 31, 2009 |
|---|---|---|
| | | Thousands of dollars |
| Allowance for doubtful accounts, opening balance | **$3,599** | $9,147 |
| Transfer from held for sale | **1,783** | 2,966 |
| Accounts written off | **(8,897)** | (13,344) |
| Recoveries | **2,094** | 4,118 |
| Provision for losses | **5,541** | 712 |
| Allowance for doubtful accounts, closing balance | **$4,120** | $3,599 |

*Note 9 – Financial instruments, continued*

| Discontinued operations | September 30, 2010 | December 31, 2009 |
|---|---|---|
| | Thousands of dollars | |
| Allowance for doubtful accounts, opening balance | $1,807 | $1,106 |
| Transfers to continuing operations | (1,783) | - |
| Accounts written off | - | (139) |
| Recoveries | - | 5 |
| Provision for losses (recovery) | (5) | 835 |
| Allowance for doubtful accounts, closing balance | $19 | $1,807 |

## Note 10 – Comparative figures

Certain of the 2009 figures have been reclassified to conform to the current period's presentation.